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ORIGINAL

FOR THE ARIZONA CORPORATION COMMISSION

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2014 JAN 17 P 4 52

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

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JAN 17 2014

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IN THE MATTER OF THE APPLICATION
 OF JOHNSON UTILITIES, L.L.C. DBA
 JOHNSON UTILITIES COMPANY, FOR AN
 INCREASE IN ITS WATER AND WASTE-
 WATER RATES FOR CUSTOMERS WITHIN
 PINAL COUNTY, ARIZONA.

DOCKET NO. WS-02987A-08-0180

NOTICE OF FILING
 TESTIMONY OF DANIEL HODGES
 IN SUPPORT OF
 SETTLEMENT AGREEMENT

Johnson Utilities, L.L.C. hereby files the Testimony of Daniel Hodges in Support of
 Settlement Agreement in the above-captioned docket.

RESPECTFULLY submitted this 17th day of January, 2014.

BROWNSTEIN HYATT FARBER SCHRECK LLP

Jeffrey W. Crockett, Esq.
 One East Washington Street, Suite 2400
 Phoenix, Arizona 85004
 Attorneys for Johnson Utilities, L.L.C.

ORIGINAL and thirteen (13) copies filed
 this 17th day of January, 2014, with:

Docket Control
 ARIZONA CORPORATION COMMISSION
 1200 West Washington Street
 Phoenix, Arizona 85007

COPY of the foregoing hand-delivered
 this 17th day of January, 2014, to:

Lyn Farmer, Chief Administrative Law Judge
 Hearing Division
 ARIZONA CORPORATION COMMISSION
 1200 West Washington Street
 Phoenix, Arizona 85007

1 Janice Alward, Chief Counsel
2 Legal Division
3 ARIZONA CORPORATION COMMISSION
4 1200 West Washington Street
5 Phoenix, Arizona 85007

6 Steve Olea, Director
7 Utilities Division
8 ARIZONA CORPORATION COMMISSION
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11 Copy of the foregoing mailed and e-mailed
12 this 17th day of January, 2014, to:

13 Daniel Pozefsky, Chief Counsel
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP – Chairman
GARY PIERCE
BRENDA BURNS
ROBERT BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION
OF JOHNSON UTILITIES, L.L.C., DBA
JOHNSON UTILITIES COMPANY FOR
AN INCREASE IN ITS WATER AND
WASTEWATER RATES FOR
CUSTOMERS WITHIN PINAL COUNTY,
ARIZONA.

DOCKET NO. WS-02987A-08-0180

TESTIMONY OF DANIEL HODGES IN SUPPORT OF
SETTLEMENT AGREEMENT
JANUARY 17, 2014

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1 **I. INTRODUCTION.**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Daniel Hodges. My business address is 5230 East Shea Boulevard,
4 Suite 200, Scottsdale, Arizona 85254.

5 **Q. DO YOU WORK FOR JOHNSON UTILITIES, L.L.C.?**

6 A. Yes.

7 **Q. HAVE YOU TESTIFIED PREVIOUSLY IN ANY PROCEEDINGS**
8 **BEFORE THE ARIZONA CORPORATION COMMISSION**
9 **("COMMISSION")?**

10 A. Yes. I have testified as a witness for Johnson Utilities in Dockets WS-02987A-
11 09-0083 and WS-02987-12-0136.

12 **II. PURPOSE OF TESTIMONY**

13 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

14 A. I am testifying in support of the Proposed Settlement Agreement ("Settlement
15 Agreement") between Johnson Utilities, L.L.C. ("Johnson Utilities" or the
16 "Company") and the Residential Utility Consumer Office ("RUCO") that was
17 filed in this docket on November 4, 2013.

18 **Q. DID YOU PARTICIPATE PERSONALLY IN THE NEGOTIATION OF**
19 **THE SETTLEMENT AGREEMENT?**

20 A. Yes. I participated over the past several months in discussions and
21 communications with RUCO which led to the Settlement Agreement.

22 **Q. WHAT IS THE PURPOSE OF THE SETTLEMENT AGREEMENT?**

23 A. As between Johnson Utilities and RUCO, the Settlement Agreement resolves all
24 issues raised in the Petition for Rehearing Pursuant to A.R.S. §40-253 filed by
25 Johnson Utilities on July 26, 2013 (the "Johnson Utilities Petition") and the
26 Application for Rehearing of Decision No. 73992 filed by RUCO on July 31,
27 2013 (the "RUCO Application").
28

1 **III. THE JOHNSON UTILITIES PETITION FOR REHEARING**

2 **Q. WHAT WAS THE ISSUE RAISED IN THE JOHNSON UTILITIES**
3 **PETITION?**

4 A. Johnson Utilities was seeking a rehearing on that limited portion of Decision
5 73992 (July 16, 2013) which imposed a new requirement that the Company file a
6 rate case for both its water and wastewater divisions no later than June 30, 2015,
7 using a 2014 calendar year test year. Please allow me to provide some
8 background.

9 On August 25, 2010, the Commission issued Decision 71854 which
10 ordered decreases in the rates and charges of Johnson Utilities for both its water
11 and wastewater divisions retroactive to June 1, 2010. Decision 71854 also
12 authorized the Company to implement a Central Arizona Groundwater
13 Conservation District ("CAGR") adjustor fee, subject to conditions proposed by
14 Staff. Johnson Utilities filed proposed CAGR adjustor fees with the
15 Commission on September 23, 2010, and the Commission approved the CAGR
16 adjustor fees in Decision 72089 (January 20, 2011) for all customer billings
17 subsequent to October 1, 2010.

18 On February 28, 2011, Johnson Utilities filed a Petition to Amend Decision
19 71854 Pursuant to A.R.S. § 40-252 to correct what the Company believed were
20 several errors in the decision. On September 15, 2011, the Commission issued
21 Decision 72579 which increased the Company's sewer rates for billings after
22 October 1, 2011, to address a correction in the Company's wastewater rate base
23 and established an 8% rate of return for the Company's wastewater division.
24 Decision 72579 also modified the late fee for wastewater service and reinstated
25 the Company's hook-up fees tariffs for the water and wastewater divisions.

26 Decision 72579 further amended Decision 71854 by ordering that "in the
27 event the Commission alters its policy to allow S corporation and LLC entities to
28 impute a hypothetical income tax expense for ratemaking purposes, Johnson

1 Utilities may file a motion to amend this Order prospectively, and Johnson
2 Utilities' authorized revenue requirement hereunder, pursuant to A.R.S. § 40-252,
3 to reflect the change in Commission policy." In Decision 73739 issued February
4 22, 2013, the Commission adopted an Income Tax Policy Statement stating that it
5 is in the public interest to allow tax pass-through entities to include income tax
6 expense as a part of their cost of service. Shortly thereafter, on March 8, 2013,
7 Johnson Utilities filed a Petition to Amend Decision 71854 Pursuant to A.R.S. §
8 40-252 to increase its test year revenue requirement to include income tax
9 expense. The Commission approved the Company's request in Decision 73992
10 issued July 16, 2013, and the new increased rates went into effect in August 2013.

11 Decision 73992 also adopted Staff's recommendation that "the Company
12 be ordered to file a full rate case application for both its water and wastewater
13 divisions by no later than June 30, 2015, using a 2014 calendar year test year."¹ It
14 was this new requirement that prompted the Company to file the Johnson Utilities
15 Petition seeking a one-year delay in the rate case filing requirement.

16 **Q. WHAT WAS THE REASON FOR STAFF'S RECOMMENDATION**
17 **REGARDING THE FILING OF A RATE CASE?**

18 A. Staff is concerned about the potential length of time between Johnson Utilities'
19 last rate case and the next rate case the Company files. Decision 73992 states as
20 follows at Findings of Fact 10-12:

21 10. In its petition, the Company stated that, if its application is approved,
22 the Company would not need new rates to be effective prior to July
23 1, 2019.

24 11. Staff notes that the new Commission income tax policy has no stay-
25 out requirements. Further, Decision No. 71854 (amended by
26 Decision No. 72579) was the Company's first rate case since the
27 granting of its Certificate of Convenience and Necessity by Decision
28 No. 60223 (May 27, 1997).

¹ Decision 73992 at page 5, FOF 21, and page 6, lines 1-2.

12. Because of the length of time between rate cases that would occur if the Company did not file a new rate application for several years, Staff recommends that the Company be ordered to file a full rate case application for its water and wastewater divisions by no later than June 30, 2015, using a 2014 calendar year test year.²

Q. DOES JOHNSON UTILITIES AGREE WITH THE BASIS OF STAFF'S RECOMMENDATION?

A. No, we disagree for several reasons. First, while Johnson Utilities' last rate case was filed in 2008, the rates in effect today were not fully adopted and implemented until August 2013, less than six months ago. As I described above, the Company's rates and charges were decreased in Decision 71854 (August 25, 2010) retroactive to June 1, 2010, but were subsequently modified three times, as follows:

- The new CAGR D adjustor fees were implemented pursuant to Decision 72089 for customer billings for water sold after October 1, 2010.
- Sewer rates were increased in Decision 72579 for billings after October 1, 2011.
- Increases in water and sewer rates resulting from the inclusion of income tax expense in the revenue requirement were implemented pursuant to Decision 73992 for billings for service provided after August 1, 2013.

Johnson Utilities has been back before the Commission almost continuously regarding its rates and charges since Decision 71854 was issued in the fall of 2010.

Second, Staff's recommendation was based upon pure conjecture that Johnson Utilities "will not file a new rate application for several years." This possibility exists with all public utilities and it is my understanding that the Commission does not typically order a utility to file a rate case by a date certain.

Rate cases are very expensive to prepare, file and prosecute,³ and rate case

² Decision 73992 at page 3, FOFs 10-12 (emphasis added).

³ I would note that Johnson Utilities spent in excess of \$1 million dollars on this rate case.

1 expense is ultimately borne by the customers through rates. Thus, in the absence
2 of some credible evidence by Staff that there is a need to file a public utility
3 should determine the timing for filing for new rates and charges based upon a
4 careful consideration of all of the relevant facts.

5 Third, Staff has provided no analysis or any basis for selecting a 2014 test
6 year as opposed to any other test year. The recommendation of a 2014 test year
7 appears to be purely arbitrary.

8 Fourth, if the Commission or Staff has a reasonable basis to believe that the
9 rates and charges of a utility are "unjust, discriminatory or preferential, illegal or
10 insufficient," then the Commission always has the authority under A.R.S. §40-203
11 to undertake a rate review with respect to the utility and to adjust the utility's rates
12 and charges based upon the outcome of that review.⁴

13 **Q. HAS STAFF PRESENTED ANY EVIDENCE THAT THE COMPANY'S**
14 **CURRENT RATES AND CHARGES ARE "UNJUST, DISCRIMINATORY**
15 **OR PREFERENTIAL, ILLEGAL OR INSUFFICIENT?"**

16 **A.** No. In fact, in evaluating the Company's request for inclusion of income tax
17 expense in its rates, Staff stated in its April 26, 2013, Staff Report and Proposed
18 Order that "Staff concurs with these amounts because they comply with the
19 Commission's new policy and will therefore result in just and reasonable rates."⁵
20 This same language was included in Decision 73992 at Finding of Fact No. 5 and
21 Conclusion of Law No. 5. There is no evidence that the Company's current rates
22 are not just and reasonable.

23 **Q. NOTWITHSTANDING JOHNSON UTILITIES' DISAGREEMENT WITH**
24 **THE BASIS OF STAFF'S RECOMMENDATION, IS THE COMPANY**
25 **OPPOSED TO A REQUIREMENT THAT IT FILE A RATE CASE?**

26
27 ⁴ Please note that I am not an attorney and this portion of my testimony is based upon my reading of
28 A.R.S. §40-203 and my understanding of Commission practice based upon my experience working for a
public utility.

⁵ Staff Report and Proposed Order dated April 26, 2013, at page 1.

1 A. No. Johnson Utilities does not oppose a requirement that it file a rate case.
2 However, the Company does oppose the requirement that it file a rate case by
3 June 30, 2015, using a 2014 calendar year test year, as I will discuss later in my
4 testimony.

5 **Q. DOES THE SETTLEMENT AGREEMENT ADDRESS THE ISSUE OF**
6 **THE TEST YEAR?**

7 A. Yes. In the Johnson Utilities Petition, the Company requested the amendment of
8 Decision 73992 to require a rate case filing by June 30, 2017, using a calendar
9 year 2016 test year. As part of the give and take negotiations which produced the
10 Settlement Agreement, Johnson Utilities agreed to file its next rate case by June
11 30, 2016, using a 2015 calendar year. This is one year later than the 2014 test
12 year ordered in Decision 73992 and one year earlier than the 2016 test year
13 requested in the Johnson Utilities Petition.

14 **Q. WILL A DELAY OF ONE YEAR IN THE RATE CASE FILING**
15 **REQUIREMENT MAKE A MATERIAL DIFFERENCE TO JOHNSON**
16 **UTILITIES?**

17 A. Absolutely. Over the next two or three years, Johnson Utilities will be investing
18 in significant plant improvements and expansions, including a major expansion of
19 a wastewater treatment plant. Much of this planned construction will not be
20 completed by the end of 2014. In addition, Johnson Utilities is experiencing
21 significant increases in power costs and the Company is preparing for the
22 implementation of the Patient Protection and Affordable Care Act (also known as
23 ObamaCare), the full financial impact of which will not be known until after this
24 year. Delaying the test year by even one year will allow the Company to include
25 the additional plant investment in rate base and the additional expenses in
26 operating expenses. Alternatively, requiring the filing of a rate case using a 2014
27 calendar year test year will very likely force Johnson Utilities to file back-to-back
28 rate cases, which would be burdensome and costly for the Company and its

customers.

Q. WOULD A ONE-YEAR DELAY IN FILING A RATE CASE HAVE ANY ADVERSE EFFECT ON THE COMPANY'S CUSTOMERS?

A. No. Johnson Utilities acknowledges and understands the legitimate interest of the Commission, Staff and customers in utilities filing periodic and regular rate cases. However, in this case Staff has provided no basis or rationale for selecting a 2014 calendar year test year over any other year, Staff has presented no evidence that the Company's current rates are in any way "unjust, discriminatory or preferential, illegal or insufficient," and I have provided legitimate reasons to support the Company's request for a one-year delay in the rate case filing requirement. Additionally, as I have previously stated, the requirement of a 2014 test year will likely result in the need for back-to-back rate cases. For all of these reasons, I do not how a one-year delay in the rate case filing requirement can have any adverse impact on customers.

IV. RUCO APPLICATION FOR REHEARING

Q. WHAT WAS THE ISSUE RAISED IN THE RUCO APPLICATION?

A. The RUCO Application speaks for itself but in short, RUCO opposed the inclusion of income tax expense in the rates and charges of Johnson Utilities as authorized in Decision 73992.

Q. HOW DOES THE SETTLEMENT AGREEMENT ADDRESS THE ISSUES RAISED BY RUCO REGARDING INCOME TAX EXPENSE?

A. Under the Settlement Agreement, Johnson Utilities agrees to reduce the applicable income tax rate from 36.66% to 25% for the Company's wastewater division.

V. ADOPTION OF THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST

Q. WHAT ARE THE BENEFITS OF THE SETTLEMENT AGREEMENT?

A. The Settlement Agreement fully resolves all disputes between RUCO and Johnson

1 Utilities pertaining to Decision 73992 and, likewise, resolves all issues between
2 the parties raised in the RUCO Application and the Johnson Utilities Petition.
3 Specifically, the Settlement Agreement provides the following benefits:

- 4 • It requires independent verification that the actual weighted average
5 income tax rate of the members of Johnson Utilities is at least equal
6 to or higher than the imputed income tax rate of 25% for the
7 wastewater division which the parties agree to in the Settlement
8 Agreement.
- 9 • It reduces the applicable imputed income tax rate from 36.6558% to
10 25.00% for the wastewater division, resulting in lower wastewater
11 rates and combined annual savings for wastewater customers of
12 approximately \$289,000.
- 13 • It requires Johnson Utilities to file a rate case by June 30, 2016,
14 using a 2015 test year.
- 15 • It requires Johnson Utilities to file yearly earnings reports, in the
16 form of the schedules attached as Exhibit A to the Settlement
17 Agreement, for the years 2013 and 2014 prior to the next rate case.
- 18 • It avoids further litigation and cost for both parties.
- 19 • It does not impair the right of RUCO to challenge or the right of
20 Johnson Utilities to support future determinations regarding the
21 imputation of income tax for limited liability companies, subchapter
22 S corporations, and other forms of tax pass-through entities.

23 **Q. HOW WILL NEW WASTEWATER RATES BE IMPLEMENTED IF THE**
24 **COMMISSION APPROVES THE SETTLEMENT AGREEMENT?**

25 A. Pursuant to Section 2.2 of the Settlement Agreement, within 30 days of
26 Commission approval, Johnson Utilities would file a revised tariff with the new
27 lower wastewater rates. The new wastewater rates would be effective for all
28 billings on and after the date of the Commission's order approving the Settlement
Agreement. The Settlement Agreement does not affect the rates for water service
approved in Decision 73992 which shall remain in effect.

1 **Q. BASED UPON THE BENEFITS YOU HAVE DESCRIBED, AS WELL AS**
2 **THE REASONS YOU HAVE PROVIDED SUPPORTING THE**
3 **COMPANY'S NEED FOR A ONE-YEAR DELAY IN THE TEST YEAR,**
4 **DO YOU BELIEVE THAT APPROVAL OF THE SETTLEMENT**
5 **AGREEMENT IS IN THE PUBLIC INTEREST?**

6 A. Yes. A negotiated settlement agreement finds common ground between the
7 parties and resolves disagreements in a way that is supported by each of the
8 settling parties. In this instance, the Settlement Agreement, if approved, will
9 result in lower wastewater rates for Johnson Utilities customers as described
10 above. It also allows the Company to use a test year for its next rate case that will
11 better reflect plant in service and cost of service, and will help the Company avoid
12 a scenario where it might otherwise be forced to file back-to-back rate cases. For
13 all of these reasons, the Settlement Agreement is in the public interest.

14 **Q. WHAT ACTION DOES JOHNSON UTILITIES REQUEST THAT THE**
15 **COMMISSION TAKE WITH RESPECT TO THE SETTLEMENT**
16 **AGREEMENT?**

17 A. Johnson Utilities requests that the Commission issue its order modifying Decision
18 73992 to adopt and/or reflect the relevant provisions of the Settlement Agreement.

19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

20 A. Yes.
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